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SUBJECT: (SBU) U.S. EXPORT CONTROLS: U/S MCCORMICK'S  
DISCUSSION WITH NDRC OFFICIALS, MAY 23, 2006

¶1. (U) This cable is SENSITIVE BUT UNCLASSIFIED; please  
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SUMMARY  
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¶2. (SBU) Commerce Under Secretary for Industry and Security  
David McCormick briefed National Development and Reform  
Commission (NDRC) Vice Chairman Bi Jingquan about  
contemplated  
changes to U.S. export controls intended to facilitate high  
tech trade while tightening restrictions on items for  
military  
end-uses. The United States is committed to working with  
China  
to have a candid and cooperative relationship on export  
control  
matters. The contemplated changes should reduce the  
administrative burden for legitimate civilian trade. U/S  
McCormick urged NDRC to share a copy or details of its study  
on  
the effects of U.S. export controls, which Vice Chairman Bi  
and  
High Technology Industries Director-General Xu Qin said  
pointed  
to USD 20 billion in opportunity costs for the United States.  
U/S McCormick repeatedly underscored that the High Technology  
and Strategic Trade Working Group recently established under  
the Joint Commission on Commerce and Trade (JCCT) presents an  
appropriate venue in which to continue export control  
discussions with appropriate Chinese officials and build  
cooperation and trade in the high technology sector. He also  
reinforced the point that the trade numbers make clear, that  
export controls are not the cause of the trade deficit.

¶3. (U) Vice Minister Bi complained that U.S. export controls  
on  
China, a Nuclear Suppliers Group member, are improper and  
discriminatory. Bi said that modernization of China's  
military  
is inevitable but not on a collision course with U.S  
interests,  
and that the U.S military should not have concerns in this

sector if Taiwan's Chen Shui-bian does not engage in independence activities. Bi argued that U.S. licensing procedures themselves deter Chinese companies from buying from the United States, that the United States should reduce the scope of goods considered to have military uses, and that the United States should provide more policy loans to U.S. exporters to facilitate U.S. exports to China. END SUMMARY.

14. (U) Vice Chairman Bi Jingquan welcomed U/S McCormick to NDRC and explained that he was hosting the meeting in lieu of the scheduled Vice Chairman ZHANG Xiaoqiang, who had to be outside of Beijing that day. After introductions of the two delegations (names at paras 24-25), U/S McCormick provided an overview of the purpose of his visit to China, his day earlier meetings with Ministry of Commerce senior officials and other recent developments in U.S. export controls.

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Committed to Work Together on Export Control Issues  
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15. (SBU) U/S McCormick began by recalling that U.S. export controls had been a subject of discussion in the April 2006 meeting of the Joint Commission on Commerce and Trade, including in remarks made by Vice Premier Wu Yi. The United States is committed to working with China to have candid and cooperative relations on export control matters. Export controls help facilitate high-tech trade. Ensuring a foundation of confidence built on export controls can increase U.S. high-

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tech exports to China, he stressed. Ministry of Commerce (MOFCOM) Vice Minister Wei and the Under Secretary's predecessor had already made real progress in cooperating on U.S. export control matters. The progress and cooperative relationship were exemplified in a number of developments:

-- U.S. high-tech exports to China increased 50 percent from 2003 to 2005;

-- the United States reduced restrictions on exports of items such as general microprocessors to civilian end-users; and

-- China's meteorological center uses an IBM supercomputer to track worldwide weather developments (the export of that equipment was subject to U.S. export controls).

He also reinforced the fact that export controls are not a significant case of the trade deficit.

16. (SBU) The JCCT had outlined a new process for cooperating on export control matters, U/S McCormick continued. MOFCOM Vice Minister MA and U/S McCormick had exchanged letters creating a High-Tech and Strategic Trade Working Group under the JCCT. This new Working Group will focus on strengthening high-tech trade. The U/S informed Vice Chairman Bi that in his May 22 meeting with MOFCOM Vice Minister Wei, the two sides had agreed that the first meeting of this new JCCT Working Group will be convened in September of this year.

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U.S. Export Control Policy Changes Contemplated  
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17. (SBU) The United States is now considering changes to its export control policy that would allow reductions in the administrative burdens placed on legitimate civilian trade, the U/S explained. The United States will continue and expand

restrictions on trade for military end-use items. The U.S. is confident that it can support both these aims at the same time, while developing great relations with MOFCOM and with China. MOFCOM has day-to-day responsibilities for handling export control matters of the United States within China, but given the importance of the issue, the Under Secretary had wanted to personally meet officials at the Foreign Ministry and NDRC to brief them on these developments.

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Bi: U.S. Export Controls Cause Big Losses for U.S. Firms  
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18. (SBU) Vice Chairman Bi affirmed the importance of U.S. export controls to China and to the NDRC. The NDRC had previously taken note of the U.S. relaxation of export restrictions on high-performance computers, and is pleased to learn that MOFCOM and the United States have established a JCCT Working Group to discuss U.S. export control policy. The NDRC is the Chinese Government agency responsible for high-tech development in China, Bi continued, and thus the NDRC deeply feels the impact of U.S. export controls. He said that the NDRC's Department of high Technology Industries, led by Director-General Xu Qin (attending this meeting), had led a group to study the impact of U.S. export controls on bilateral trade relations and on China's high-tech sector. That study had concluded that U.S. export controls result in lost opportunities for U.S. companies amounting to USD 20 billion per year. Trade in U.S.-made goods such as integrated circuits, high performance computers, numerically controlled machine

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tools, semiconductors, satellites, propulsion equipment and other items are affected by U.S export controls. Bi averred that China sees no direct relationship between those goods and military end uses or military products. He urged further consideration of how to define which goods have military uses. He rhetorically asked whether cotton imported from the United States for manufacturing of clothing in China, some of which might be used in the manufacture of military uniforms, should be subject to U.S. export controls.

19. (SBU) Bi said that China is happy to see that the united States has noted the negative impact of its high-tech export controls policy, which Vice Premier Wu Yi had raised as long ago as the fifteenth (2004) meeting of the JCCT. He praised establishment of the JCCT Working Group to discussing lifting U.S. export control restrictions and said that the NDRC would happily cooperate in discussing these issues with the U.S. side.

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Bi: An Equal Nuclear Suppliers Group Member  
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10. (SBU) Bi stressed that China is now a member of the Nuclear Suppliers Group (NSG), fulfilling its obligations and responsibilities therein. However, China does not enjoy the license-free treatment that other NSG members do. China thinks this different treatment is improper, discriminatory, and difficult to understand or accept.

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U/S: Study Would Facilitate Discussion  
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¶11. (SBU) U/S/ McCormick rejoined that the impact of export controls is an interesting topic of analysis. U.S. studies of this issue have suggested that the impact is far smaller and that export controls are not a significant cause of the trade deficit. The United States would welcome the opportunity to see NDRC's analysis - indeed, a translation of the study could become the basis of discussion with NDRC or in the new JCCT Working Group. With respect to definitions of dual-use technology, some cases are difficult but usually they are quite clear-cut, such as technologies with applications for military munitions.

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Military Modernization - and Taiwan's Chen Shui-bian  
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¶12. (SBU) The purpose of the new JCCT Working Group is not to eliminate trade restrictions but to both make them more effective and to increase legitimate civilian trade. President Bush has said that U.S. policy is to engage China, strengthen our relationship with China and cooperate with China. In candor, several areas of concern about China remain Modernization of China's military is one such area, and that is the basis for the U.S. decision not to export technologies that could be used for military purposes. The U.S and china agree in many areas, and this may be one area in which they disagree. Vice Chairman Bi noted that military modernization is not within the NDRC's area of responsibility, but modernization of China's military is an inevitable trend. However, China thinks that its military modernization is not in collision with U.S interests. The U/S noted that military modernization is not

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within USDOC's portfolio, either.

¶13. (SBU) Vice Chairman Bi said that China understands the U.S. military's concern. If Chen Shui-bian (note: Taiwan's president) does not engage in independence activities, there will not be grounds for U.S. concerns in this regard.

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Military End-Use Control  
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¶14. (SBU) Bi then said china has heard that the United States will make stricter export controls under the Wassenaar Arrangement. If true, China is concerned that such a move would bring a larger negative impact on bilateral trade.

¶15. (SBU) U/S McCormick replied that the military end-use control that resulted from the 2003 Wassenaar Statement of Understanding had been discussed in some detail in his May 22 meeting with MOFCOM Vice Minister Wei (septel). Two components are under consideration. The first would increase high-tech trade and reduce the burden of licensing procedures on U.S. and certain trusted Chinese companies. Chinese companies and importers with a long track record of using technologies for civilian purposes would be identified, and those so identified would face fewer licensing requirements or even see such requirements eliminated. This approach is consistent with the shared objective of increasing U.S. high-tech trade with

China.

¶16. (SBU) The second component under consideration would place further restriction on certain technologies. These technologies currently do not require license, but if used for military purposes, have significant military utility. These technologies would only be restricted and would not need a license when going to military end-uses. The U/S provided a hypothetical example of a technology that might have health care applications in a military hospital and not be restricted, but would be restricted if that same technology were instead destined for use in fighter aircraft production. Such adjustments would be consistent with the guidelines for the new JCCT Working Group and for promoting high-tech trade. The U/S noted that the policy adjustments are not yet finalized but are currently under consideration.

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Bi: Four Points on U.S. Export Controls  
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¶17. (SBU) Vice Chairman Vi said he hopes that U.S. export control policy adjustments will be conducive to bilateral trade, especially trade in the high-tech sector. Regarding U/S McCormick's recommendation that NDRC's study on the impact of U.S. export controls be shared with the USG, Bi said further exchanges on that topic would be possible. Bi then offered four points (referring to a document he had brought to the meeting) on U.S. export controls.

¶18. (SBU) First, due to U.S. export controls, Chinese entities no longer apply for many civilian use goods. In 2004 and 2005, for example, China had purchased two satellites from France instead of the United States, impacting U.S. trade by some

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USD 150 million to USD 300 million. (NOTE: Congress has designated satellites as munitions items under State Department licensing jurisdiction. Because of Tiananmen Square sanctions, a State Department license and Presidential waiver is required for U.S. exports of satellites to China.)

¶19. (SBU) Second, the process for Chinese entities to apply for required licenses is very difficult, so many have stopped applying for licenses. Bi said this is reflected by the fact that Chinese imports of integrated circuits in 2005 amounted to USD 81.1 billion, but only USD 4 billion - about 6 percent of China's import of this type of product, came from the United States. Similarly, less than 10 percent (USD 1.6 billion of a total USD 16.5 billion) of China's imports of numerically controlled machine tools came from the United States. In both these areas, Bi said, the United States has world-leading technology and is highly competitive. Total Chinese imports of these goods amount to about USD 100 billion. If U.S. firms could supply one-third of China's demand, U.S. exports in these two categories alone would climb to USD 30 billion. Bi

clarified

that he was not saying that the United States does not allow these goods to be exported to China, rather that the approval procedures are too complicated and make relevant agencies' responsiveness so untimely as to make Chinese importers not even try to purchase these goods from U.S. firms. Chinese firms are reluctant to even approach USG agencies about export control matters, and see the difficulties encountered in getting a necessary license in a timely fashion as a trade barrier established by the USG. Thus the NDRC is pleased to hear that the new JCCT working group will work to make U.S. export controls more effectiveness, and those that are retained should be made more transparent. More timely issuance of U.S. export licenses would create a more predictable market environment, which surely could lead to an increase in Chinese imports of U.S.-made integrated circuits and numerically controlled machine tools.

120. (SBU) Third, regarding dual-use or military-use items, Bi stated that the United States does not permit export to China of dual-use or police-use items or low-end military goods, such as large helicopters, high performance computers, fine processors and navigation equipment. So Chinese firms do not apply for USG licenses for such items.

121. (SBU) Fourth, the United States places many limitations on policy loans that could support U.S. export sales. Bi urged the U/S to place attention on this matter, as policy loans could support increased exports of U.S.-made power generation equipment, medical equipment and other high-tech goods. Lifting restrictions on U.S. policy loans would be conducive to bilateral trade as a whole.

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U/S: Look to Working Group for Detailed Discussions  
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122. (SBU) U/S McCormick thanked Vice Chairman Bi for his views and points. He reiterated interest in receiving the valuable insights that the NDRC analysis of the impact of U.S. export controls could provide. The JCCT Working Group on High-Tech

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and Strategic Trade will be an effective forum for addressing questions about the effectiveness, procedures, transparency and predictability of U.S. export licensing procedures. USDOC's Bureau of Industry and Security does not have responsibility for loan issues, but the U/S anticipated having opportunity to pass on the Vice Chairman's comments to the head of the U.S. Export-Import Bank at a meeting during the week of May 29.

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Export Controls One of Reasons for the Trade Imbalance  
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123. (SBU) Vice Chairman Bi replied that if the U.S. made efforts to lift export controls on high-tech items, bilateral trade could see a great development conducive to relieving the trade imbalance between our two countries. U/S/ McCormick said that many factors create the trade imbalance, and candidly, export controls are not one of them. But there is much the two sides can do together in this area and the United States is



committed to do its part.

¶24. (SBU) Vice Chairman Bi ascribed the trade imbalance to globalization and the global division of labor. Many U.S. high-tech companies, such as Intel, Microsoft, Hewlett-Packard and Motorola, are setting up factories in China which export to the United States. Furthermore, many Asian companies are shifting their exports to the United States from factories in their home countries to their factories in China. These developments definitely increase the U.S. trade deficit with China, but are an inevitable trend, Bi said. But many of the benefits of that trend accrue to U.S. companies and U.S. consumers, Bi asserted. He said he had visited a company in the Shanghai area which manufactures thirteen million laptops per year. For every USD 100 in exports by that company, the company has imported USD 45 in parts, usually from Japan, South Korea, Hong Kong, Taiwan or the United States. Five dollars have been incurred in labor costs for each USD 100 in exports, and the company has five dollars in profit and depreciation. Only USD 45 of each USD 100 in exports in Chinese parts content. However, U.S. companies like Intel, Compaq, and Dell sell the final product in the United States under their own trademarked names at a 50 percent mark-up, Bi claimed.

¶25. (SBU) China does not purposely seek a large trade imbalance with the United States, and China expects that its imports will continue to grow. China expects the United States to adjust its export control policies so as to increase U.S. exports to China. U/S McCormick's visit to China is highly significant, and with joint efforts, China hopes cooperation and trade in the high-tech sector can be promoted, Vice Chairman Bi concluded.

¶26. (SBU) U/S McCormick agreed that there is opportunity to grow high-tech relations in a way that is still consistent with U.S. policy not to support military modernization, and much on both sides can be done to facilitate that. The JCCT High-Tech and Strategic Trade Working Group is the forum in which to

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continue this discussion. The U/S said he looked forward to working with MOFCOM Vice Minister Wei and his team and with NDRC officials on these matters.

¶27. (U) National Development and Reform Commission participants in this May 22 meeting were:

Vice Chairman BI Jingquan  
Director-General XU Qin, Department of High Technology Industries  
Deputy Director-General LI Bin, Department of Foreign Affairs  
Division Director LI Fang, Department of Foreign Affairs  
Interpreter

¶28. (U) USG participants were:

Under Secretary of Commerce for Industry and Security David McCormick  
Special Assistant to the Under Secretary Michael DiPaula-Coyle  
Minister-Counselor for Commercial Affairs Craig Allen

Jeannette Chu, Export Control Attache, Commercial Section  
Economic Section Deputy Chief Christopher Beede  
Interpreter

129. (U) The Under Secretary's delegation has cleared this  
report.

RANDT